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THE RELATION BETWEEN FEDERAL AND STATE TAXATION

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In the past the United States for the most part has collected its revenues from duties on imports, but at periods of unusual need has levied taxes on land, occupations, incomes, deeds and other contracts, and many other subjects. Since the Civil War taxes have also been levied on certain manufactures. The national revenue in the fiscal year 1913 aggregated \$724,111,230, exclusive of postal receipts. Of this sum, \$318,891,396 came from customs and \$344,416,966 from "internal revenue," which is, of course, chiefly from the manufacture and consumption of whisky, beer and tobacco. In the year 1914 a third important source of revenue has been added, namely, the income tax. The states, in their turn, are practically free to tax the persons and property within their borders in any way they may see fit.

In the past the federal government and the states have selected their fields of taxation from the standpoint of opportunity and expediency, rather than according to the methods of logic or the principles of finance. If we may judge the future by the past, each jurisdiction will likely continue, for sometime, to use that field of taxation which best suits its convenience. For that reason I deem it wholly unwise and unnecessary to map out any so-called "proper field" of taxation either for the federal government or for the state governments. In other words, the scope of this paper must be the practical problem of the relation of federal and state taxation, rather than the theoretical problem of the proper field for each jurisdiction. Omitting this purely academic discussion, we still have left the serious problems of assessment and collection—surely a field big enough to engage all our energies. I believe if the problem is examined in this practical way, the investigation will finally lead to coöperation among the present overlapping and conflicting jurisdictions, and ultimately will give us a solution of the problem of the "proper field."

1. *Taxation An Interstate Question*

Let us consider briefly the situation that now confronts us. More and more the property and the business in a state are becoming interstate in nature. For purposes of illustration, take a few concrete cases. In Chicago there are certain great mail order houses whose sales run up into the millions, probably hundreds of millions of dollars a year. These houses do business in every state in the Union and in foreign countries as well. In reality this gigantic business is interstate. But in actual practice, under our uncoordinated systems of state and federal taxation, this business is assessable only at its domicile in the state of Illinois.

The International Harvester Company, to illustrate further, sells farm machinery not only in the United States but throughout the world. It is incorporated in one state, has factories in four or five other states, has warehouses in many more states, and does business in yet other states of the Union. Hence this great corporation, which is a business unit, is subject to taxation by many competing jurisdictions, not as a business unit, but as so many pieces of tangible property in the competing states. Some states may assess it too high; some too low; others not at all; but in any event there is small likelihood that justice will be done either to the corporation or to the states themselves. This is clearly not a state problem, but a problem concerning a group of states. Yet the states involved do not cooperate in meeting the situation. The same difficult condition obtains in regard to all the great industrial corporations—oil, steel, tobacco, sugar, etc.

If we turn to another field of state taxation—the inheritance tax—we find a great need, and a great lack, of interstate comity. For instance, Mr. A, a resident of Minnesota, dies. His will provides that his property consisting of North Dakota farm mortgages shall pass to a legatee living in Wisconsin. Will this estate be taxed once, twice, or three times? Three times. To quote the department of commerce's *Special Report on Taxation* (December, 1913, p. 9):

The present method of taxing inheritances in Wisconsin, as in all other states except New York and Massachusetts, namely, subjecting the same property to taxation twice or perhaps three times in as many states is unjust, and there is probably no greater need among the states for uniformity of tax laws than in the taxation of inheritances.

This situation is not merely bad; it is steadily growing worse.

The great field which we technically know as "interstate commerce" I have not mentioned at all. The problem of taxing the railroad has never been solved and never can be solved by any one state acting alone. There are two questions involved here, namely: (1) What is the value of the road? (2) What share of this value is assignable to the state in question? The Pennsylvania road recently built a few miles of road in the state of New York, including one of the finest and most costly terminal stations in the world. The cost of this small section of road was great enough to pay for the construction and equipment of a first class road from New York to San Francisco. But where shall this terminal be assessed? Shall its value be assigned to New York or to all the states reached by the Pennsylvania system? No state has arrived at precision in determining the value of a railroad. Space is lacking to show the various methods used and various results obtained in assessing the same railroad by adjoining states. No state can make an assignment of railroad values to other states, even though it had a proper method of assigning these shares, and even though it had worked out precision in assessment. The thought must occur to every reader at this point that the federal government has now, in the interstate commerce commission, a body adequately equipped to value all railroads with scientific precision, and fully able to assign such values to the individual states. It has taken us ninety years of experimentation in railroad matters to work out this piece of government machinery. Now that we have it, why not use it to its full efficiency?

What is said of railroads applies in the main to such businesses as the telegraph, telephone and express companies; dining and sleeping car companies; private car lines; light, heat, and power companies operating across state lines; and interstate trolley lines.

A National Conference on Taxation was held in Buffalo in 1901, under the auspices of the National Civic Federation, and at this conference the following resolution was unanimously adopted:

WHEREAS, modern industry has overstepped the bounds of any one state and commercial interests are no longer confined to merely local interests; and

WHEREAS, the problem of taxation cannot be solved without considering the mutual relations of contiguous states, be it

Resolved, that this conference recommend to the states the recognition and enforcement of the principles of interstate comity in taxation. These principles require that the same property should not be taxed at the same time

by two state jurisdictions, and to this end that if the title deeds or other paper evidences of the ownership of property, or of any interest in property, are taxed, they shall be taxed at the situs of the property, and not elsewhere. These principles should also be applied to any tax upon the transfer of property in expectation of death, or by will, or under the law regulating the distribution of property in case of intestacy.

Since this resolution was adopted there has been no increase in comity among the states. But there has been an enormous growth in conflicting legislation.

A council of states has been suggested as a proper body to deal with the complex problems just cited. But no such council has yet been formed or is likely soon to be formed. A National Tax Association, devoted to the study of state and local taxation, was formed at Columbus, Ohio, in 1906. A significant step was taken by this latter association at its 1913 meeting, when it was decided to enlarge the scope of the activities of the association to include a study of federal taxation. And at the 1914 meeting of this association in Denver, a large part of the discussion was devoted to the relation between federal and state taxation. It is evident from the foregoing, therefore, that while no solution has been as yet reached, the problem is at last being formulated, and being formulated moreover in its total aspect, as an interstate as well as a local and a national problem.

The formulation of the problem has suggested a few steps towards its solution. It has turned our faces in the direction of coöperation in the place of the present crassly competitive, individualistic method.

2. The Need—Coöperation

The steady increase in federal and state expenditures—outstripping our increase in both wealth and population—makes it high time to seek out some remedy for the growing defects in our tax systems.

The difficulties and failures in our state methods and the useless duplication and waste in both federal and state methods suggests coöperation between state and nation as the next step. The suggestion has already been made that in assessment of interstate commerce corporations the federal government could wisely coöperate with the separate states. Such a step could be taken without involving any constitutional amendments.

The federal government has now added the income tax to its fiscal system. This tax is in all probability to be a permanent feature of our financial system. And the states will, with the further example of Wisconsin's success with a state income tax before their eyes, soon look to this form of tax as offering a practicable remedy for the evils of the personal property tax. The commissioner of internal revenue has all the administrative machinery necessary for determining the size of the individual taxpayer's income. Why should this costly machinery be duplicated? Already the states' tax commissions, boards of equalization, and other administrative machinery are high in cost, and low in efficiency. More simplification and less duplication are needed. And this means more coöperation.

Interstate industrial corporations cannot be justly assessed by the separate states. They can be so assessed by the federal government. Indeed the new federal trades commission will likely perform this very function. Such valuations should be certified to the tax officials of the various states, not merely for purposes of checking up the work of these officials, but for final assessment purposes.

Thus far we have been treading on ground where there is not room for very great differences of opinion. However, if we proceed further with the idea of coöperation we are at once on debatable ground. Should the federal government, for instance, assume the task of assessing personal property, especially those forms of personalty which by their intangibility and mobility defy state laws? Should the federal government assume the duty of assessing all business corporations, thus with one fell stroke cutting the Gordian knot of assessing justly that artificial "person" consisting in part of tangible property, in part of intangible securities? Should the federal government even go so far as to collect the tax in any or all the foregoing cases? Conceivably the tax could be collected in this manner and be distributed to the states on some pre-determined basis.

3. Dangers Real and Fancied

I am sure the critic will interpose some objections at this point. The staunch New Englander will say: "We believe in local self-government. We manage our own affairs. And we resent any outside interference with our cherished historical institutions."

While this sentiment must be respected, yet the real issue is not to be shirked. What is the best tax system? That is the real question. Is our present individualistic, helter skelter system as good as the proposed coöperative system? Local self-government has gone to seed in many places, not omitting New England. The federal government already has prescribed rules for taxing national banks. The states follow these rules. In like manner the federal government could wisely establish rules for, or do the actual work of assessing incomes, interstate commerce, and other forms of business enterprise. In this matter we should be governed by the wider questions of cost and efficiency, rather than by any doctrinaire principles of states' rights. The danger lies on the side of too much decentralization of the assessing power. The *taxing power*—the vital thing—will in any event remain exactly where it is now. Hence the cry to "save the local assessor" is a belated cry. It is an *administrative* reform we seek, not a legislative reform.

4. *Future Development*

The ideal method of assessing property would have a minimum of arbitrary procedure. Exact mathematical formulas in determining values are desirable but unattainable. But progress must be towards the use of rules which are simple and applicable, and machinery which combines simplicity with low cost and high efficiency. This means no duplication and much coöperation. This means precision and publicity.

Coöperation in assessment and collection of taxes, as outlined in the preceding pages, will lead to a division of the field of taxation, a division based on administrative experience, not on preconceived theory. It will also lead, it is hoped, to a business-like coördination of the federal administrative machinery itself, which is now represented by the following organs and functions: the interstate commerce commission which is now gathering and publishing facts regarding the values of our greater public utilities; the bureau of the census in the department of manufactures; the bureau of statistics in the department of agriculture which collects and publishes statistics concerning crop values; the treasury department which determines the size of incomes and administers the federal income tax.